Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1970

No. 477

RKO GENERAL, INC.,

Petitioner,

—v.—

MARGOT NEWMARK,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR REHEARING

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The Petitioner, RKO General, Inc. ("RKO"), respectfully moves this Court for an order (1) vacating its denial of certiorari, entered on October 12, 1970, and (2) granting the petition.

Grounds for Rehearing

Subsequent to the denial of Certiorari by this Court, the SEC (1) has denied RKO's Application for a Rule concerning the applicability of Section 16(b) to mergers and related stock purchases, and (2) has received an Amended Application for a Rule concerning the definition of "profit realized" for purposes of Section 16(b).

In light of these developments, the Court may wish to solicit the views of the SEC in considering this Petition for Rehearing.

On October 13, 1970, following this Court's denial of certiorari, the Securities and Exchange Commission

("SEC") denied RKO's Application for a Rule which would have exempted certain stock purchases in connection with corporate mergers from Section 16(b) of the Securities Exchange Act of 1934 (the "Act"). RKO had urged the SEC to adopt the proposed rule pursuant to the authority of the SEC to exempt by rule or regulation those transactions "not comprehended within the purpose" of Section 16(b).[1] The rule proposed by RKO would have applied retroactively and, if adopted by the SEC, would have exempted the transaction in issue from Section 16(b).

Denial by the SEC of RKO's Application for a Rule threatens to leave RKO without remedy to correct the improper application of Section 16(b) liability which was imposed by the courts below. Moreover, the SEC's action means that only this Court can authoritatively determine here how Section 16(b) should be applied to mergers and related stock purchases.

Subsequent to the SEC's October 13, 1970 denial of RKO's initial Application for a Rule, RKO was informally advised by a Commissioner of the SEC that the SEC may be willing to consider a rule relating to the definition of "profit realized", as that term is used in Section 16(b). No representations were made, of course, with respect to the action which the SEC might take on such a rule.

It is decidedly in the public interest to clarify the law concerning "profit realized" under Section 16(b). And on October 20, 1970, RKO filed with the SEC an Amended Application for Adoption of Rule (Appendix A hereto, pages 1a to 7a *infra*). In this Application, RKO has urged

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[1] Section 16(b) provides in pertinent part:

"This subsection shall not be construed to cover . . . any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection."

that, for purposes of Section 16(b), the term "profit realized" should be defined to mean any liquidated profit received in the form of cash or cash equivalent, when that term is applied to any transaction involving the purchase of securities in contemplation of and conditioned upon a statutory merger of the issuing company with another corporation. Such a rule would, of course, exempt transactions like the one in issue from Section 16(b).

RKO has urged that the proposed "profit realized" rule should be adopted retroactively. We cannot, of course, predict whether the SEC will adopt the rule proposed or whether that rule, if adopted, will apply retroactively.

Thus, unless this Court is advised to the contrary by the SEC, the basic Section 16(b) issues raised by this case can only be determined by this Court. As the Court will recall, in May 1967, RKO entered into a single business deal to purchase control of Central Airlines, Inc. ("Central") and to merge Central into Frontier Airlines, Inc. ("Frontier"), a company in which RKO then owned a majority interest. Thus RKO contracted to purchase shares representing a controlling interest in Central from several major Central shareholders *conditional upon* the merger of Central into Frontier. The merger was approved by the shareholders of both companies after full and accurate disclosure of all relevant facts (including the RKO stock purchase conditional upon the merger). After all necessary approvals had been obtained, the stock purchase and merger were executed on a single day.

Because the stock purchase came first on that day, the courts below held that there was a "purchase" of Central stock and then an immediate "sale" of that stock in exchange for the stock of Central-Frontier, the merged company. The Central stock, converted into Central-Frontier stock by operation of the merger, cost RKO approximately

$7.5 million; however, on the day of the merger and stock purchase, Central-Frontier stock was supposedly worth some $15.5 million to RKO. RKO has never sold or otherwise liquidated its holding of the Central-Frontier stock obtained on the day of the merger; nevertheless, the courts below held that RKO "realized" on that day a Section 16(b) profit of nearly $8 million, the largest judgment ever entered under Section 16(b).

The stock for which RKO paid $7.5 million in 1967 is still held by RKO and has a market value today of some $2.3 million. Rather than "realizing" any profit on the stock purchase and merger, RKO faces an actual loss of approximately $5.3 million—even if RKO is not required to pay the additional $8 million judgment imposed below.

Section 16(b) was designed to take the profit out of insider in-and-out trading. Here, however, RKO got "in" but to this day has not gotten "out." RKO made a Section 16(b) "purchase" but no Section 16(b) "sale"; moreover, RKO never "realized" any "profit" on the transaction.

In our Petition for a Writ of Certiorari, we urged that it is of great public importance for the Court to decide whether a corporate merger *cum* stock purchase gives rise to Section 16(b) liability. In view of the subsequent denial by the SEC of our Application for a Rule concerning mergers and related stock purchases, and in view of the uncertainty surrounding our Amended Application for a Rule concerning "profit realized," it is now of even greater importance that this Court hear and finally determine these issues. Mergers and related stock purchases are frequent, important commercial transactions. The decision below adversely affects such transactions in a manner never contemplated by the framers of Section 16(b).

This Court should grant certiorari.

CONCLUSION

For the reasons set forth above, as well as those contained in the Petition for Writ of Certiorari, Petitioner prays that this Court grant rehearing of the order of denial, vacate that order, grant the petition and review the judgment and opinion below.

Respectfully submitted,

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October 23, 1970

Certificate of Counsel

I, RICHARD J. WERTHEIMER, one of the counsel for the Petitioner, do hereby certify that the foregoing petition for rehearing is presented in good faith and not for delay and is restricted to the grounds specified in Rule 58(2).

RICHARD J. WERTHEIMER
Counsel for Petitioner

APPENDIX A

Administrative Proceeding
File No. .....

BEFORE THE

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C.

In the Matter of

RKO GENERAL, INC.
1440 Broadway
New York, New York 10018

Securities and Exchange Act of 1934

Amended Application for Adoption of Rule

On September 3, 1970, RKO General, Inc. ("RKO") filed an application, pursuant to Rule 4(a) of the Commission's Rules of Practice, requesting that the Commission adopt a rule exempting certain transactions from the operation of Section 16(b) of the Securities Exchange Act of 1934 (the "Act"). At that time there was pending before the Supreme Court a petition for certiorari filed by the applicant in *RKO General, Inc.* v. *Margot Newmark*. On October 12, 1970, the Supreme Court denied the applicant's petition for certiorari in that case. On October 13, 1970, the Commission denied the application of RKO for the requested rule.

Subsequent to such denials, the applicant was advised by Commissioner Richard B. Smith that the Commission may be willing to consider a rule relating to the defini-

tion of "profit realized" as that term is used in Section 16(b) of the Act. Commissioner Smith, of course, made no representations with respect to the action which the Commission might take on such a rule.

The applicant believes it to be decidedly in the public interest that the Commission have an opportunity to consider such a rule. Surely the result in *Neutmark* v. *RKO General, Inc.*, 425 F.2d 328 (2d Cir. 1970), in the Second Circuit indicates that a "profit realized" rule implementing the Commission's previously expressed policy on the subject would be quite timely. Accordingly, RKO by this Amended Application hereby requests, pursuant to Rule 4(a) of the Commission's Rules of Practice, that the Commission adopt a rule relating to the definition of "profit realized" as that term is used in Section 16(b) of the Act.

Section 3(b) of the Act provides that the Commission "shall have power by rules and regulations to define technical, trade, and accounting terms used in this title insofar as such definitions are not inconsistent with the provisions of this title." The proposed rule relating to the definition of "profit realized" as that term is used in Section 16(b) would, in effect, exempt certain transactions from the operation of that Section of the Act. Such a result would not, however, be inconsistent with the provisions of that Section.

Section 16(b) establishes an absolute rule that any profit realized by insiders from a purchase and sale (or sale and purchase) of a security within a six-month period shall be recoverable by the issuer. This rule was intended by Congress to prevent insiders from profiting through the unfair use of inside information. Recognizing, how-

ever, that under certain circumstances, the application of the Section may be unnecessary, harsh or inappropriate. Section 16(b) provides that it "shall not be construed to cover . . . any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection."

I. *The Proposed Rule*

The rule which we propose for adoption, pursuant to the sections cited above, would provide as follows:

> (a) For the purposes of section 16(b) of the Act, the term "profit realized", as applied to any transaction involving the purchase of securities in contemplation of and conditioned upon a statutory merger of the issuing company with another corporation, means any liquidated profit received in the form of cash or a cash equivalent.
>
> (b) Any transaction specified in paragraph (a) with respect to which there was no "profit realized" as defined in paragraph (a) shall be exempt from the provisions of section 16(b) of the Act, and no liability under that section shall arise with respect thereto.
>
> (c) This rule shall apply to any transaction occurring before or after the effective date of this rule.

II. *The Reasons Why the Rule Should be Adopted*

The reasons for the adoption of the proposed rule were discussed at length in the applicant's Application for Adoption of Rule filed with the Commission on September 3, 1970, to which the Commission is hereby referred. These reasons are best illustrated, however, by transactions involving the applicant in *Newmark* v. *RKO General, Inc.*, 294 F. Supp. 358 (S.D.N.Y. 1968), *aff'd*, 425 F.2d 348

(2d Cir. 1970), *cert. denied*, 39 U.S.L.W. 3142 (U.S. Oct. 12, 1970). In that case, the District Court and the Second Circuit held that Section 16(b) is applicable to the transaction described below. As previously noted, the petition for certiorari filed in the Supreme Court by the applicant with respect to that case has been denied. Applicant intends to file a petition for rehearing with the Supreme Court. However, the Supreme Court's action with respect to such a petition for rehearing cannot be predicted.

Applicant, RKO General, a wholly-owned subsidiary of the General Tire & Rubber Company, in May 1967 entered into a contract to purchase shares representing a controlling interest in Central Airlines, Inc. from several major Central shareholders at $8.50 per share, and to purchase an issue of convertible debentures at the same price, based on the shares into which the debentures were convertible. This stock purchase agreement was concluded at the same time as was an agreement providing for merger of Central Airlines, Inc. into Frontier Airlines, Inc., a company 56 percent of whose stock was owned by RKO, and the stock purchase agreement was conditioned upon the completion of the merger. The merger was conditional upon stockholder approval of both companies, which was obtained in full compliance with the Commission's proxy rules. The merger was also conditional upon the approval of the CAB which was also obtained.

The District Court and the Second Circuit held that the transactions executed on the same day constituted a "purchase" of the Central stock at $8.50 per share, and a "sale" of that stock in exchange for stock in the merged company. Since the Central stock purchased by RKO for some $7.5 million was exchanged for stock in the

merged company, which had on the closing date a value of some $15.5 million, the District Court held that RKO "realized" on that one day—the closing date—a profit of nearly $8 million for purposes of Section 16(b).

RKO continues to hold the investment in the merged company which it made on September 18, 1967, and its investment in that company today has a market value of some $2.3 million, an actual loss of approximately $5.2 million—even if it is not required to pay an additional $8 million judgment.

The applicant believes that the kind of transaction described above does not constitute the sort of insider trading which Section 16(b) was designed to prevent. The applicant realized no profit as a result of the transaction—in fact it sustained an actual loss. The proposed rule by defining "profit realized" to include only those liquidated profits received in the form of cash or a cash equivalent would clarify what was undoubtedly the intent of Congress with respect to Section 16(b) and would avoid such harsh inequities as those suffered by the applicant with respect to Section 16(b) liability.

The proposed "profit realized" rule would simply confirm the Commission's previously stated position on this question. In *Heli-Coil Corp.* v. *Webster*, 352 F.2d 156 (3d Cir. 1965), the Commission appeared as *amicus curiae* and argued that the securities conversion in issue produced no *liquidated* profit and, therefore, no "profit realized" within the meaning of Section 16(b). The Commission stated, at page 14 of its *amicus* brief:

> "When used with reference to investments, the term 'realized' generally refers to the *liquidation* of an investment position and the collection of whatever profit

> has accrued. Although in some situations the statutory purpose may require a broader concept, this is not such a case. In no real sense did Mr. Webster *liquidate* his position to collect a profit when he converted. . . . It is thus apparent that for market or speculative purposes the debenture was, at that time, substantially the economic equivalent of the common stock into which it was convertible. After the conversion, as before, Mr. Webster retained his investment position in the securities of Heli-Coil and whatever profits had accrued continued to be at the risk of the market and could disappear without 'realization' if the market price of the common were to decline substantially. In the parlance of investors, these profits continued to be 'paper' profits both before and after the conversion." [Emphasis added.]

We submit that the proposed rule, articulating the Commission's position and the *Heli-Coil* holding with respect to "profit realized", would be most timely. Since we cannot predict what action, if any, the Supreme Court will take concerning applicant's petition for rehearing, we urge that the proposed rule be adopted retroactively. In *Blau* v. *Max Factor*, 342 F.2d 304 (9th Cir. 1965), the Commission in its *amicus curiae* brief urged the retroactive application of Rule 16b-9 which was adopted some two years after the transaction in question. Relying primarily on *SEC* v. *Chenery Corp.*, 332 U.S. 194, 203 (1947), and *Addison* v. *Holly Hill Fruit Products, Inc.*, 322 U.S. 607 (1944), the Commission vigorously argued that such retroactive application was particularly appropriate where the transactions were of a type clearly not comprehended by the statute, to which, even in the absence of a rule, the statute might well not apply. In view of the circumstances in the present case,

the applicant urges, that under these well-established principles the proposed rule be adopted retroactively.

Respectfully submitted,

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Dated: October 20, 1970